

DEPARTMENT OF STATE REVENUE

04-20170897.LOF

Letter of Findings Number: 04-20170897
Sales and Use Tax
For Tax Years 2014 through 2016

NOTICE: IC § 6-8.1-3-3.5 and/or IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this document.

HOLDING

Indiana Business demonstrated that the "Beverage Stations" at its restaurants consumed more electricity than the audit determined. Indiana Business however failed to substantiate that it purchased and used a "Gravy Cooker" in its restaurants. Indiana Business also failed to substantiate its overall objection of "Load Factor" on other pieces of equipment.

ISSUE**I. Sales and Use Tax - Exemption.**

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-1; IC § 6-8.1-5-1; *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Rhoads v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466 (Ind. Tax Ct. 1993); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Aztec Partners, LLC v. Indiana Dep't of State Revenue*, 35 N.E.3d 320 (Ind. Tax Ct. 2015); [45 IAC 2.2-3-4](#); [45 IAC 2.2-3-14](#); [45 IAC 2.2-4-13](#); [45 IAC 2.2-5-8](#).

Taxpayer protests the assessments concerning sales/use tax on electricity which it purchased and consumed at its various restaurants.

STATEMENT OF FACTS

Taxpayer is in the fast food restaurant business, which operates various locations throughout the State of Indiana. Taxpayer previously filed a GA-110L form, claiming a full refund of sales tax paid to its vendors on utility, including electricity it purchased, based on its utility study. Relying on the same utility study, Taxpayer filed several ST-200 Forms (Utility Sales Tax Exemption Applications) and obtained various Indiana Utility/Communication Sales Tax Exemption Certificates (ST-109 Forms) (*hereinafter*, "Exemption Certificates") from the Indiana Department of Revenue ("Department"). The Exemption Certificates allow Taxpayer to receive refunds of the sales tax it previously paid from 2014 through 2016 and also to purchase and use the electricity at its business locations without paying any sales or use tax going forward.

In 2017, the Department conducted a sales/use tax audit of Taxpayer's business records for the tax years 2014, 2015, and 2016. The audit examined and attempted to verify Taxpayer's purchase and use of electricity, exempt or otherwise, stated in Taxpayer's utility study. After the auditor toured two business locations of Taxpayer's - 002 and 003 - and perused Taxpayer's utility study, the Department determined that Taxpayer's business locations did not qualify for the 100 percent - predominant use - exemption.

The audit further determined that Taxpayer qualified for a 43 percent exemption on electricity at location 002, and 47 percent at location 003. In turn, the audit applied 47 percent exemption to the remainder of Taxpayer's business locations, except location 002. The audit noted that Taxpayer "stated that the equipment from this restaurant [location 003] is the exact same as the other restaurants besides location 002." Ultimately, the audit revoked Taxpayer's Exemption Certificates and determined that a portion of the electricity used at its various business locations was subject to sales/use tax at either 53 percent or 47 percent. The audit assessed additional

sales/use tax, which also included the sales tax which previously was refunded in error by the Department to Taxpayer based on Taxpayer's utility study.

Taxpayer protested the audit assessment. An administrative hearing was held during which Taxpayer's representative explained the basis of Taxpayer's protest. Essentially, in addition to the "load factor" on various pieces of equipment, Taxpayer disagreed with the audit findings on several items, including two "Beverage Station[s]" and a "Gravy Cooker" used at its restaurants. This decision ensues, addressing Taxpayer's protest. Additional facts will be provided as necessary.

I. Sales and Use Tax - Exemption.

DISCUSSION

After the audit, the Department found that Taxpayer was not entitled to the predominant use exemption on the electricity purchased and used at its restaurants. Nonetheless, the audit found that Taxpayer qualified for a partial, 43 percent or 47 percent, exemption on electricity its restaurants used.

Taxpayer, to the contrary, argued that its utility study supported that each of its restaurants qualified for the predominant use tax exemption. Specifically, Taxpayer disagreed with the Department's audit adjustments regarding (1) two "Beverage Station[s]," (2) a "Gravy Cooker," and (3) the "Load Factor" on various pieces of equipment, including a "Digital Gas french fry/tater tot unit," a "Broiler Control," several "Oven[s]," a "Vitamix Blender," a "Water Filtration System," a "Multiplex CO2 and water filter," an "Ice Machine," and two "Bun Holding/Warming Cabinet[s]."

Accordingly, the issue here is whether Taxpayer demonstrated that its purchase and use of the electricity qualified for the predominant use tax exemption.

As a threshold issue, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoads v. Indiana Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Rhoads*, 774 N.E.2d at 1048; *USAir, Inc. v. Indiana Dep't of State Revenue*, 623 N.E.2d 466, 468 - 69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. *Rhoads*, 774 N.E.2d at 1047 - 50 (explaining that, generally, states impose a use tax to prevent the erosion of the state's tax base when its residents make purchases in other states). To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. IC § 6-2.5-3-2(a); *USAir, Inc.*, 623 N.E.2d at 468. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

Moreover, all purchases of tangible personal property generally are taxable unless specifically exempted by Indiana law. [45 IAC 2.2-5-8\(a\)](#). An exemption from the use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4 and [45 IAC 2.2-3-4](#). There are various tax exemptions available under [IC 6-2.5-5](#); these enumerated exemptions also apply to transactions which are subject to Indiana

use tax. [45 IAC 2.2-3-14](#). A statute which provides a tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id.* at 101 (internal citations omitted). In applying any tax exemption, "[t]he general rule is that tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

An exemption from sales and use tax is provided for tangible personal property purchased for use in direct production of other tangible personal property. This exemption is found in IC § 6-2.5-5-1, which states:

- (a) As used in this section, "tangible personal property" includes electrical energy, natural or artificial gas, water, steam, and steam heat.
- (b) Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. This exemption includes transactions involving acquisitions of tangible personal property used in commercial printing.

In the case of electrical usage, [45 IAC 2.2-4-13](#) explains:

- (a) In general, the furnishing of electricity, gas, water, steam, or steam heating services by public utilities to consumer is subject to tax.
- (b) The gross receipt of every person engaged as a power subsidiary or a public utility derived from selling electrical energy, gas, water, or steam to consumers for direct use in direct manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in [IC 6-2.5-4-5](#) shall not constitute gross retail income of a retail merchant received from a retail transaction. Electrical energy, gas, water, or steam will only be considered directly used in direct production, manufacturing, mining, refining, oil or mineral extraction, irrigation, agriculture, or horticulture if the utilities would be exempt under [IC 6-2.5-5-1](#).
- (c) Sales of public utility services or commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, horticulture, or another public utility or power subsidiary described in [IC 6-2.5-4-5](#), based on a single meter charge, flat rate charge, or other charge, are excepted if such services are separately metered or billed and will be used predominantly for the excepted purposes.
- (d) Sales of public utility services and commodities to consumers engaged in manufacturing, mining, production, refining, oil or mineral extraction, irrigation, agriculture, or horticulture, based on a single meter charge, flat rate charge, or other charge, which will be used for both excepted and nonexcepted purposes are taxable unless such services and commodities are used predominantly for excepted purposes.
- (e) **Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are used predominantly for excepted purposes. Predominant use shall mean that more than fifty percent (50[percent]) of the utility services and commodities are consumed for excepted uses.**
(Emphasis added).

Therefore, only when 50 percent or more of electricity sold from a single meter is used in an exempt manner, does the purchaser qualify for a predominant use exemption pursuant to [45 IAC 2.2-4-13\(e\)](#). To state it differently, when the purchaser purchases electricity through one single meter which is predominantly used for exempt purposes, namely production, the electricity sold through that meter is wholly exempt from sales tax and use tax. In order to qualify for the exemption, a taxpayer must show that "1) it is engaged in production, 2) it has an integrated production process, and 3) the electricity is essential and integral to its integrated production process." *Aztec Partners, LLC v. Indiana Dep't of State Revenue*, 35 N.E.3d 320, 324 (Ind. Tax Ct. 2015).

Taxpayer in this instance argued that its utility study supported that each of its restaurants qualified for the predominant use tax exemption. Specifically, Taxpayer disagreed with the Department's audit adjustments regarding (1) two "Beverage Station[s]," (2) a "Gravy Cooker," and (3) the "Load Factor" on various pieces of

equipment, including a "Digital Gas french fry/tater tot unit," a "Broiler Control," several "Oven[s]," a "Vitamix Blender," a "Water Filtration System," a "Multiplex CO2 and water filter," an "Ice Machine," and two "Bun Holding/Warming Cabinet[s]." To support its protest, Taxpayer offered additional documentation, including a two-page installation requirements summary for a Coca-Cola Fountain, pictures of carbonators and "gravy warmer," its "Depreciation Expense Report As of December 31, 2017," and an Excel summary of its Fluke Load Analysis.

Upon review, the two-page summary demonstrated that "[a] separate 115 volt, 20 amp, grounded duplex outlet is needed for each drink dispenser, carbonator, or air compressor." Thus, the Department's Enforcement Division is requested to verify and recalculate the electricity usage of the "Beverage Station" in a supplemental audit. Upon verification, the Department will recalculate the electricity usage of the equipment and, in turn, adjust the exempt percentage as needed.

As to "Gravy Cooker," Taxpayer referencing the "gravy warmer" picture stated that "[e]ach restaurant has one of these. The [audit] has these listed under non-exempt, however, tax law states that these should be exempt." The Department however is not able to agree. Specifically, Taxpayer acknowledged that "we pay cash for smaller items like the gravy warmers, so those wouldn't show up on the list [of Depreciation Expense Report]." Without verifiable records to support Taxpayer's purchase for its restaurant business, the Department could not consider how Taxpayer used the equipment. Even if, assuming that Taxpayer purchased and owned the equipment, Taxpayer erroneously relied on the *Aztec Partners* decision. As stated in *Aztec Partners, LLC*, electricity is exempt if the equipment is engaged in production, has integrated production process, and is essential and integral to the production process. Taxpayer must demonstrate that it purchased and used the "Gravy Cooker" in its production. Taxpayer failed to establish the requirements outlined in *Aztec Partners*.

Finally, referencing the Excel summary of its "Fluke Load Analysis," Taxpayer objected to the audit adjustments of "Load Factors" with regards to various pieces of equipment. In its utility study, Taxpayer asserted a higher "Load Factor" for a "Digital Gas french fry/tater tot unit," a "Broiler Control," several "Oven[s]," a "Vitamix Blender," a "Water Filtration System," a "Multiplex CO2 and water filter," two "Bun Holding/Warming Cabinet[s]," and an "Ice Machine." Taxpayer subsequently provided a table of "transaction per hour" stating that "the transaction per hour are very consistent between 5am and 12am. So for 19 hours per day, these restaurants are busy. . . ." Taxpayer maintained that "the [audit's] Load Factors are too low."

Upon review, however, the Department is not able to agree that Taxpayer met its burden to demonstrate that the audit was incorrect. Specifically, Taxpayer did not provide verifiable source documentation to support its calculation of the "Load Factors." Without verifiable source documentation, the Department could not verify the information stated in the Excel summary of Taxpayer's "Fluke Load Analysis" and the transactions at its restaurants.

In short, given the totality of the circumstances, the Department is prepared to agree that Taxpayer's documentation demonstrates that its two "Beverage Station[s]" should have higher percentage of exempt use than the audit adjustments. However, the Department is not able to agree that Taxpayer met its burden to demonstrate that the audit was incorrect for the remaining items.

FINDING

Taxpayer's protest of two "Beverage Station[s]" is sustained subject to a supplemental audit review. The remainder of Taxpayer's protest is respectfully denied. To the extent that the supplement audit, upon verification, recalculates and determines that Taxpayer uses 50 percent or more of electricity in its production, Taxpayer qualifies for the predominant use exemption. Otherwise, Taxpayer qualifies for a partial exemption based on the actual use.

This determination is not final until the supplemental audit review is concluded and its companion supplemental report is issued.

March 21, 2018

Posted: 05/30/2018 by Legislative Services Agency
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